

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA**

In re:

CASE NO. 02-11913-BKC-AJC

PSN USA, INC.,

Debtor.

_____ /

PARTIAL FINDINGS OF FACT AND CONCLUSIONS OF LAW

THIS CAUSE came before the Court for evidentiary hearing on February 15, 2007 and again on March 30, 2007 upon the *Motion to Remove Dan Fair as Liquidating Trustee and for Related Relief* (CP 834). At the conclusion of the hearing, the Court announced that the Liquidating Trustee mismanaged the PSN Liquidating Trust (the “Trust”) by failing to comply with the First Amended Plan of Liquidation (the “Plan”), by commingling funds into one account contrary to the express language of the Plan, for paying fees without court approval, which actions may result in the

disgorgement of fees paid to both the Trustee and his counsel, and by failing to establish an interest-bearing “Reserve Account” for the \$1 million earmarked for the unsecured creditors. However, while grounds existed to remove the Liquidating Trustee, the Court determined that the best interest of the creditors and the administration of the estate is served by ordering the Trustee to not make any further disbursements, pending further order of Court, and appointing an Examiner to study and report on the financial transactions, receipts and disbursements in this case, and compare same with the Plan and the Liquidating Trust Agreement. The appointment of an Examiner pursuant to 11 U.S.C. §105 has been accomplished by a separate order.

On the record at the hearing, the Court announced that three (3) issues remained unresolved:

1. Whether the objection to the NOB claim was in bad faith?
2. What was the procedure contemplated in the Plan for the payment of creditors, specifically unsecured creditors?
 - A. How was the Cash Collection Account and the Reserve Account to be funded?
 - B. Were the funds deposited into the Reserve Account to be held inviolate or were they available to pay the Trustee’s fees and expenses?
3. Whether an accounting can resolve the issue of the commingling of funds?

The issue of whether the objection to the NOB claim was in bad faith will not be decided at this time. The Court will await the report of the Examiner and thereafter consider this issue further, after all interested parties have had an opportunity to be heard.

The Court will herein address the other remaining issues, to wit, what was the procedure to be used for distributions to unsecured creditors and whether an accounting procedure can resolve the

issue of the commingling of funds. To resolve these questions, the Court has carefully reviewed the Plan and the Liquidating Trust Agreement.

I. Background

On December 24, 2002, the Court confirmed the Plan, which provided for the creation of the Trust and the transfer of substantially all of the Debtor's assets to the Trust on the Plan's Effective Date. *See* Confirmation Order (CP 446) and Plan (CP 363). The Plan embodies, in part, a settlement between the Debtor's only secured creditor, Pan American Sports Partners ("PASP"), and the Official Committee of Unsecured Creditors (CP 446). PASP's secured claim exceeded the value of the Debtor's assets, which by the date of the Confirmation Order consisted primarily of \$3.1 million in cash. In return for broad releases in its favor and in favor of its affiliated companies and certain individuals, PASP agreed to carve-out more than \$1 million for the unsecured creditors, in settlement of its claim for \$725,000 plus \$257,000, more or less, for attorneys fees, plus a percentage of the collection of receivables and avoidance actions. Although the US Trustee objected to the scope of these releases, the Court confirmed the Plan.

On the Effective Date, the Trustee received and distributed approximately \$3.1 million in cash and credits representing the assets of Debtor's estate. From his testimony at the trial though, Mr. Fair indicated that he received only about \$2.9 million, attributing the difference to a credit for the amount retained for attorneys fees. From those funds, it appears the Trustee disbursed \$725,000 to PASP, \$500,000 to employees pursuant to an employee carve-out and \$200,000 to unsecured priority claimants. The Trustee also testified that the holders of Allowed Unsecured Claims were paid about \$50,000. After deduction of the foregoing payments on the Effective Date, the Trustee stated that he received at the "end of the Effective Date" approximately \$1.4 million.

The Trustee initially testified that approximately \$960,000 was reserved for the payment of

the Disputed [Unsecured] Claims. However, during his continued testimony, Mr. Fair's recollection differed on the amount reserved for the Disputed Claims. He testified at one point that \$926,000 was reserved and later testified that \$875,000 was deposited into an account reserved for the payment of the Disputed [Unsecured] Claims. One thing of which he was certain, no distributions were made to the unsecured creditors after the Effective Date and the initial \$50,000 distribution to them.

The Trustee did not segregate the funds intended for the unsecured creditors in an interest-bearing "Reserve Account" for later disbursement, but instead deposited the \$875,000 or \$926,000 or \$960,000 in the same account where he deposited the \$50,000 intended as the "Objection Reserve" [payable to professionals for services associated with avoidance actions], and approximately \$400,000 to \$500,000 intended as a reserve for general administrative expenses. Mr. Fair referred to the account in which the funds were commingled as the "Depository Account" and this account was not an interest-bearing account. For purposes of identification, that account will be referred to as the "Commingled Account."

Mr. Fair thereafter used the funds in the Commingled Account to pay expenses incurred in administering the Trust, and to make payments to his counsel and himself, and to PASP. As of this date, Mr. Fair's actions depleted the Commingled Account, and the funds specifically earmarked for the unsecured creditors holding Disputed Claims, leaving a balance of around \$575,000 in the Commingled Account. No evidence was presented by either party on whether or not the Trustee has retained sufficient funds to fulfill the obligation to the unsecured creditors.

II. Terms of the Plan and Liquidating Trust Agreement

The Plan required the Trustee to distribute substantially all of the Trust's available cash to claim holders on the Effective Date of the Plan, which occurred on January 6, 2003. Section 3.06(a) of the Plan provides, in pertinent part:

Initial Distributions. On the Effective Date of the Plan, the PSN Liquidating Trustee shall pay: (i) Allowed Administrative Claims in full; (ii) Allowed Unsecured Priority Claims in full; (iii) the Objection Reserve, and (iv) the amounts payable to Allowed Non-Priority Unsecured Claims and PASP pursuant to Sections 2.02(b)(1) and 2.03(b)(1) of the Plan. On the Effective Date, the PSN Liquidating Trustee shall also distribute funds representing the Net Cash Proceeds (excluding Net Cash Proceeds received from the recoveries on Avoidance Actions) held by the PSN Liquidating Trustee on the Effective Date in order to make the Distributions to Allowed Non-Priority Unsecured Claims and PASP pursuant to Sections 2.02(b)(2) and 2.03(b)(2) of this Plan. . . . The funds to be used to make the initial distributions shall be comprised of the Estate's cash on hand as of the Effective Date, as well as the pre-petition retainers held by professionals and the agreed carve-out negotiated in connection with use of cash collateral with respect to awarded professional fees.¹

This of course was impossible to accomplish because of the vast amount of Disputed Claims which were not liquidated by January 6, 2003.² Accordingly, the Trustee disbursed \$725,000 to PASP, \$500,000 to employees pursuant to an employee carve-out and \$50,000 to the holders of allowed unsecured claims. The remaining \$950,000 from the \$1 million carve-out for unsecured creditors was to be deposited into a Reserve Account until such time as all Disputed Claims were either allowed or disallowed.

A. The Reserve Account

Pursuant to section 3.07(c) of the Plan, the Trustee was to make a "distribution" to the Reserve Account to be held in trust for unsecured creditors whose claims become Allowed Claims,

¹ Section 1.49(A) of the Plan defines "Net Cash Proceeds" as including all of the remaining cash on hand on the Effective Date after the distributions are made to the Allowed Administrative Claimants, the Allowed Unsecured Priority Claims, the Objection Reserve, and the Allowed Non-Priority Unsecured Claims and PASP. Sections 2.02(b)(2) and 2.03(b)(2) of the Plan requires the Trustee to distribute on the Effective Date all such Net Cash Proceeds, 90% to PASP and the remaining 10% to the unsecured creditors. The Plan does not however require that Net Cash Proceeds consisting of recoveries from avoidance actions be distributed on the Effective Date, as none of the Net Cash Proceeds available on the Effective Date consisted of such recoveries because no avoidance actions had yet been brought.

² The Debtor objected to approximately 95% of the dollar amount of unsecured claims and none of those objections had been resolved as of the Effective Date.

after all the Disputed Claims had been allowed or rejected. The Trustee was to retain in the Reserve Account sufficient funds to pay each existing claim a pro-rata portion of its full face amount in the event that all Disputed Claims were ultimately allowed. In the event that all Disputed Claims were allowed, the Allowed Claims paid on the Effective Date would have then been considered to be paid in full and the balance of the Reserve Account would have been distributed pro-rata to the other Allowed Claims. If any of the Disputed Claims were disallowed, then the funds in the Reserve Account would have been distributed to the holders of Disputed Claims whose claims had been allowed, and an additional distribution would be made to the initial holders of Allowed Claims, to even their dividend to the pro-rata share paid on all Allowed [Unsecured] Claims. Section 3.07(c) provides:

Distribution on Disputed Claims. When calculating distributions to be made under the Plan. . . the PSN Liquidating Trustee shall take into consideration the estimated amount of any Disputed Claim when calculating the Pro Rata distribution under the Plan; however, any distribution to any holder of a Disputed Claim shall be deposited into a reserve account to be maintained by the PSN Liquidating Trustee.

Section 3.09(b) of the Plan provides for the deposit to and disposition of distributions made under the Plan to any holder of a Disputed Claim from the Reserve Account:

The PSN Liquidating Trust and PSN Liquidating Trustee shall deposit all amounts required to be reserved under the Plan into an interest bearing account separate from the Cash Collection Account. The monies deposited into the Reserve Account shall be comprised of Distributions under the Plan to any holder of a Disputed Claim. Such funds shall remain in the Reserve Account until any Disputed Claim is adjudicated or settled, following which the funds shall be distributed to any holder of a Disputed Claim on the next Distribution Date following the date upon which such Disputed Claim becomes an Allowed Claim. If any Disputed Claim is disallowed or Allowed in amount less than the Disputed Claim, the difference shall be made available for distribution to holders of Allowed Claims.

Notwithstanding the express language of section 3.09(b), the Trustee did not reserve the funds

intended for distribution to unsecured creditors in an interest bearing account, and further did not segregate those funds from all other funds. Instead, contrary to the provisions of the Plan, the Trustee commingled the balance of the \$1 million for unsecured creditors with the Objection Reserve and the funds which were to be used for general expenses of the estate.

B. The Objection Reserve

The Trustee was required to reserve, in a separate account, \$50,000 to be used to pay fees and expenses incurred for resolving Disputed Claims and avoidance actions. Pursuant to section 3.06(a) of the Plan, the Trustee was required to fund the Objection Reserve on the Effective Date. The Plan, at section 1.50, defines the Objection Reserve as:

All fees and costs to be reasonably expended by the PSN Liquidating Trustee in pursuing and resolving objections to Claims, Actions and Avoidance Actions. The amount of the Objection Reserve shall be \$50,000.

The Trustee's testimony indicates the \$50,000 Objection Reserve was not segregated but in fact deposited in the Commingled Account with the funds of the unsecured creditors. The Trustee testified that the \$50,000 amount proved to be insufficient to cover all fees and expenses incurred from the litigation of the claims and avoidance actions. Notwithstanding, he continued to pay the fees and expenses, in excess of the \$50,000 amount, from the funds in the Commingled Account.

C. Payment of Estate Expenses Pursuant to Trust Agreement

Finally, the Trust Agreement provides, in paragraph 3.6(a), that the Trustee may reserve a portion of Trust assets to cover anticipated costs of administering the Trust:

. . . prior to making any distribution to holders of Liquidating Trust Interests . . . the Liquidating Trustee may retain or reserve such amounts as . . . are reasonably necessary to meet contingent liabilities and . . . to pay reasonable estimated administrative expenses.

The Trustee's testimony on the amount he reserved pursuant to this provision varies, but essentially he testified he reserved anywhere from \$400,000 to \$500,000 for these expenses, which amount he also deposited into the Commingled Account.

III. Conclusions

The Plan required Mr. Fair to deposit all of the cash received from the Debtor into a Cash Collection Account. Section 3.09(a) of the Plan directs that funds in the Cash Collection Account were to be used to pay the Trust's administrative expenses before they were to be used to make Plan distributions. On the Effective Date, Mr. Fair was required to pay existing administrative claims and all Effective Date distributions set forth in section 3.06(a). In order for him to make a distribution to the holders of Disputed Claims, Mr. Fair was required to transfer cash from the Cash Collection Account into a Reserve Account pending resolution of the Disputed Claims. Once the funds were deposited into the Reserve Account, they would no longer be available for the payment of other claims or expenses. The Plan contemplated that once funds were deposited into the Reserve Account, they became subject to the terms and conditions set forth in section 3.09(b), which prohibit Mr. Fair from withdrawing funds until they could be disbursed to the unsecured creditors.

Section 3.09(b) of the Plan unambiguously provides that the Reserve Account was to be used for only one purpose – to preserve distributions to unsecured creditors under the Plan until resolution of the Disputed Claims. The plain language of that section mandates that the funds deposited into the Reserve Account “shall remain” there until the Disputed Claims are resolved. Section 1.59 of the Plan expressly provides that the purpose of the Reserve Account is to assure that sufficient funds will be available for disbursement to the unsecured creditors once the Disputed Claims are resolved.

The funds which were to be maintained in the Reserve Account were to be comprised of “distributions” under the Plan to holders of Disputed Claims. The funds were not to be commingled

and used to pay administrative costs and fees. While there are several provisions of the Plan and Trust Agreement which authorize the Trustee to retain and compensate professionals upon approval by the Court, none of those provisions authorize the use of Reserve Account funds to pay such compensation. Had the deposit of the \$950,000 earmarked for the unsecured creditors been properly made into a Reserve Account, they would have become trust funds for the benefit of the unsecured creditors.

Section 3.09(a) of the Plan explicitly provides that the Trust's reasonable costs of administration are to be paid from the Trust's Cash Collection Account. As Trustee, Mr. Fair had the discretion to reserve any amount he deemed appropriate for the payment of expenses for administering the Trust; however, once he reserved that amount and distributed the remaining cash to the unsecured creditors, by depositing that cash in what was to be the Reserve Account for the Disputed Claims, the funds deposited for the benefit of the unsecured creditors were to be held inviolate.

The Trustee was authorized to pay the expenses incurred for administering the Trust, including fees incurred by the professionals, from the Cash Collection Account. He was also authorized to pay fees to the professionals for services associated with the avoidance actions from the \$50,000 Objection Reserve. He was not authorized to use the guaranteed amount promised to unsecured creditors, \$950,000, to pay any fees or expenses of the Trust. If the \$50,000 Objection Reserve was insufficient to cover the fees of the professionals for services provided in the avoidance actions, the Trustee could have sought permission from the Court to pay such additional sums from the Cash Collection Account. However, he was not authorized to use the funds that were to be segregated for the benefit of unsecured creditors.

At this point, the Court is unable to calculate how much in fees were paid from the

Commingled Account for professional services incurred in the avoidance actions, how much were paid for administering the Trust, and how much were wasted in frivolous litigation. The Trustee's accounting is woefully inadequate. It is totally unacceptable for a fiduciary to come before a court to report on the performance of fiduciary duties and not be able to identify, with precision, the amount of funds disbursed or transferred. The Trustee's testimony in this area, which varied as much as \$100,000 regarding reserve for expenses and from \$960,000 to \$926,000 to \$875,000 for amounts deposited in an account for unsecured creditors, is not acceptable performance of the duties by a fiduciary. The Court will await the report of the Examiner to determine whether there is a deficit in the funds earmarked for the Reserve Account that were to be held inviolate for the benefit of the unsecured creditors whose Disputed Claims became allowed. At that time, the Court will determine the level of harm, if any, caused by the Trustee's mishandling of the trust funds and craft an appropriate remedy. It is

ORDERED AND ADJUDGED that the procedure contemplated under the Plan was to fund the Cash Collection Account, and then fund the Reserve Account with the funds remaining in the Cash Collection Account, after payment of various costs and expenses, taxes and maintenance of the Trust; once the "distributions" to holders of Disputed Claims were deposited, into what was supposed to be the Reserve Account, they were to be held inviolate.

#

Copies furnished to:

Robert Charbonneau, Esq.
Edward Griffith, Esq.
Soneet Kapila, Examiner
AUST